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No. 09-647

In the Supreme Court of the United States

ROBERT W. SHIMER, ET AL., PETITIONERS

v.

COMMODITY FUTURES TRADING COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether a person who solicits funds for the purpose of commodity futures trading, but does not directly engage in such trading, can be a "commodity pool operator" within the meaning of 7 U.S.C. 1(a)(5).

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 3a-29a) is reported at 572 F.3d 150. The opinion of the district court is reported at 537 F. Supp. 2d 677. Earlier opinions and orders of the district court (Pet. App. 32a-41a, 42a-43a, 44a-52a, 53a, 54a-56a) are unreported.

JURISDICTION

The judgment of the court of appeals (Pet. App. 30a-31a) was entered on July 13, 2009. A petition for rehearing was denied on September 9, 2009 (Pet. App. 57a-58a). The petition for a writ of certiorari was filed on November 27, 2009. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. The Commodity Exchange Act (CEA or Act) gives the Commodity Futures Trading Commission (CFTC) broad regulatory power over the conduct of participants in commodity futures markets. See 7 U.S.C. 1 *et seq.* Such markets generally allow investors to buy and sell futures in either individual commodities or in what are known as "commodity pools." Commodity pools are the "commodity-futures equivalent of a mutual fund," *Rosenthal & Co.* v. *CFTC*, 802 F.2d 963, 965 (7th Cir. 1986), in that they aggregate the money of many investors so that it can be invested into a variety of futures by the operator of the commodity pool.

The Act does not define the term "commodity pool," but it defines the term "commodity pool operator" to include:

> any person engaged in a business that is of the nature of an investment trust, syndicate, or similar form of enterprise, and who, in connection therewith, solicits, accepts, or receives from others, funds, securities, or property, either directly or through capital contributions, the sale of stock or other forms of securities, or otherwise, for the purpose of trading in any commodity for future delivery on or subject to the rules of any contract market or derivatives transaction execution facility

7 U.S.C. 1a(5). Commodity pool operators are required to register with the CFTC, 7 U.S.C. 6n, and unregistered operators may not "make use of the mails or any means or instrumentality of interstate commerce in connection" with their business as operators, 7 U.S.C. 6m(1). Commodity pool operators are also subject to civil liability for fraud. See 7 U.S.C. 6b(a)(2), 6*o*.

2. Petitioners are associated persons of Equity Financial, which was the manager of Shasta Capital Associates (Shasta). See Pet. App. 6a. Between June 2001 and March 2004, petitioners solicited for Shasta approximately $15 million for the purpose of investing in a commodities futures fund called Tech Traders. *Id.* at 6a-8a. Shasta's "Private Placement Memorandum" made clear that investor funds would be used for futures trading, stating that the Shasta funds would be placed with a trading company that would provide access to a "privately managed index futures trading 'portfolio,'" which "takes a unique synergistic approach to the computerized trading of futures contracts on selected financial markets." R. 337-12. Tech Traders pooled the Shasta funds with its other investment funds and used them, in part, to trade exchange-traded commodity futures contracts and foreign currency contracts. R. 337-1.

The CFTC filed a complaint against petitioners, alleging that they were engaged in fraud in violation of 7 U.S.C. 6b(a)(2), 6*o*. R. 1, 64. Petitioners moved for summary judgment on the grounds (as relevant here) that Shasta was not a "commodity pool operator" within the meaning of the Act. See R. 230, 231. In October 2005, the district court denied the motion for summary judgment. Pet. App. 32a-41a. The court concluded that, because Shasta was an investment vehicle in which participant funds were pooled for the purpose of trading futures contracts, Shasta was a commodity pool operator within the meaning of the Act. See *id.* at 39a-40a. The district court held that, so long as Shasta was a vehicle for pooled investments in futures, it was immaterial whether Shasta traded futures directly or whether it traded indirectly through a larger fund such as Tech Traders. See *id.* at 40a-41a.

In February 2008, following a bench trial on remaining issues, the district court entered judgment in favor of the CFTC. 537 F. Supp. 2d 697-700. The court held that petitioners had committed fraud in or in connection with futures transactions, in violation of 7 U.S.C. 6b(a)(2), see 537 F. Supp. 2d at 698, and that petitioners were liable for wrongdoing by Equity under 7 U.S.C. 13c(b) because they were controlling persons of Equity, see 537 F. Supp. 2d at 699.

3. The court of appeals affirmed. Pet. App. 3a-29a. Petitioners' principal argument on appeal was that Equity was not a "commodity pool operator" within the meaning of the Act because Shasta, the fund that Equity managed, did not trade commodity futures contracts directly. *Id.* at 14a.

The court of appeals rejected that contention. The court observed that, under the applicable statutory definition, "[a] commodity pool operator must engage in a business of a particular form; it must solicit, accept, or receive funds, securities, or property; and the solicitation must have a particular purpose—trading commodity futures." Pet. App. 15a. The court further explained that "[t]he solicitation, acceptance, or receipt of funds must be 'for the purpose of trading,' but nothing in the statute imposes an actual trading requirement." *Ibid.* (quoting 7 U.S.C. 1a(5)). The court of appeals concluded that "[t]he plain language of § 1a(5) requires only that the entity be engaged in a business of the proper form, and [that] it solicit, accept, or receive funds for the purpose of trading." *Id.* at 15a-16a.

Petitioners argued that the Ninth Circuit in *Lopez* v. *Dean Witter Reynolds, Inc.*, 805 F.2d 880 (1986), had imposed a direct trading requirement, and that the court of appeals in this case should follow that precedent. Pet.

App. 18a. The Third Circuit held, however, that *Lopez* was inapposite because the legal question in that case was "whether the Dean Witter investment vehicle was an entity of the proper form." *Id.* at 19a. The court explained that "[t]he *Lopez* court confronted different facts and a different legal question. It did not address whether a commodity pool operator must itself execute commodity futures transactions." *Ibid.*

ARGUMENT

The court of appeals correctly held that an entity may be a "commodity pool operator" within the meaning of 7 U.S.C. 1a(5) if it solicits funds for the purpose of trading commodities futures, even if it does not engage in such trades directly. That ruling does not conflict with any decision of this Court or another court of appeals. Further review is not warranted.

1. The court of appeals correctly held that Equity was a commodity pool operator. That holding is supported by the text of Section 1a(5) and by the purpose and drafting history of that provision. Section 1a(5) does not limit the term "commodity pool operator" to entities that themselves trade commodity futures, but more broadly encompasses entities that solicit funds for the purpose of conducting such trades.

As the Act defines the term, a commodity pool operator must do two things. First it must be "engaged in a business that is of the nature of an investment trust, syndicate, or similar form of enterprise." 7 U.S.C. 1a(5). Second it must "solicit[], accept[], or receive[]" assets from the public "for the purpose of trading in any commodity for future delivery." *Ibid.* Section 1a(5) contains no language limiting the term "commodity pool operator" to persons who themselves directly conduct futures

trading. The statute refers to futures trading as the "purpose" for which funds are solicited, accepted, or received, but it does not specify who must do the trading.

Adoption of petitioners' interpretation, moreover, would frustrate the purposes of the statutory scheme by affording wrongdoers an easy way to evade statutory provisions designed to protect "unsuspecting traders" from deceptive practices. See H.R. Rep. No. 975, 93d Cong., 2d Sess. 64 (1974) (explaining that a primary concern of Congress was the use of deceptive practices to solicit funds from prospective pool participants). Under petitioners' interpretation of Section 1a(5), individuals could establish a pool and entice participants with deceptive claims about high profitability or low risks, but avoid liability for fraud or failure to register so long as they arranged for their pool to trade through another entity. That result would subvert the intent of the statute. See *CFTC* v. *R.J. Fitzgerald & Co.*, 310 F.3d 1321, 1329 (11th Cir. 2002) (explaining that the CEA is "a remedial statute that serves the crucial purposes of protecting the innocent individual investor—who may know little about the intricacies and complexities of the commodities market—from being misled or deceived"), cert. denied, 543 U.S. 1024 (2004).

The CFTC has consistently interpreted the term "commodity pool operator" to include pools that indirectly trade futures by investing in other commodity pools. For example, the CFTC's regulation on performance disclosures by commodity pools sets forth circumstances in which a pool is required to disclose information about "investee pools" in which it has invested.

17 C.F.R. 4.25(c)(4)-(5).[1] The *Federal Register* release for those rules made clear that the CFTC anticipated circumstances in which all of a pool's assets might be placed with investee pools. See 60 Fed. Reg. 38,159 (1995) (referring to the fact that "a substantial portion of the pool's assets, all of the pool's assets, or even [due to leverage] a multiple of the pool's assets, may effectively be allocated to * * * [certain] investee pools").

Similarly, Appendix A to 17 C.F.R. Part 4 provides guidance for commodity pool operators that operate "fund-of-funds" pools (see note 1, *supra*) regarding the circumstances in which such pools can qualify for certain exemptions from the usual requirement that operators register with the CFTC. Appendix A includes specific guidance for "fund-of-funds" entities that invest in other commodity pools but do no futures trading of their own. 17 C.F.R. Pt. 4 App. A, Situation 1. This guidance necessarily reflects the premise that operators of such funds are "commodity pool operators" within the meaning of the Act, because otherwise they would have no need for exemptions from registration.

The court of appeals was therefore correct to hold that the Act's definition of "commodity pool operator" contains no direct trading requirement. The text of Section 1a(5), its remedial purpose, and CFTC regulations on the subject all support that holding.

2. Petitioners argue (Pet. 10-20) that the decision below conflicts with the Ninth Circuit's ruling in *Lopez* v. *Dean Witter Reynolds, Inc.*, 805 F.2d 880 (1986). That is incorrect. As the court of appeals in this case recognized, the court in *Lopez* considered a different

[1] An investee pool, also known as a "fund-of-funds," is "any pool in which another pool or account participates or invests." 17 C.F.R. Pt. 4 App. A and 4.10(d)(4).

issue, and its holding is consistent with the Third Circuit's decision in this case. In fact, no other court of appeals has squarely considered the question presented here.

In *Lopez*, the Ninth Circuit considered whether the defendant broker's investment program was a commodity pool under the Act. See 805 F.2d at 882, 883. Customers of the brokerage house maintained individual accounts, and a portion of some customers' investments went into a pooled account that was used for trading commodity futures contracts. See *id.* at 882 n.2. Each customer's ability to participate in specific trades depended on the balance in that customer's individual account: not all customers participated in all trades, and the profits or losses allocated to each customer depended on the trades in which that customer had participated. See *ibid.*; *id.* at 884.

The court in *Lopez* held that, in order to constitute a commodity pool under the Act, a business must commingle the funds of various investors into a common fund, which is used to execute transactions on behalf of the entire account. 805 F.2d at 884. The court stated in particular that an essential characteristic of a commodity pool is that "participants share pro rata in accrued profits or losses from the commodity futures trading." *Ibid.* The court concluded that the investment program at issue in that case "did not have the necessary characteristics to constitute a pool." *Ibid.* The court explained that "[t]here was a disparity in investment in the individual accounts, and because of the equity level required to engage in certain purchases and trades, not all accounts traded the same contracts. Therefore, not all accounts shared a pro rata profit or loss." *Ibid.*

The issue in *Lopez* was not whether an entity must directly execute trades in order to be a commodity pool operator. Indeed, as the court of appeals in this case recognized, the defendant in *Lopez* "traded the funds at issue from its own account." Pet. App. 19a. The *Lopez* court's holding that no commodity pool was involved was based on the distinct ground that the investors in that case did not share pro rata in profits and losses. The court of appeals in this case correctly recognized the distinction between the two inquiries and the absence of any conflict between its decision and the ruling in *Lopez*. See *ibid.* (explaining that the court in *Lopez* "did not address whether a commodity pool operator must itself execute commodity futures transactions"). No feeder funds were at issue in *Lopez*, and the court did not address feeder funds even in dictum.[2]

3. Petitioners also argue, for the first time in their petition for a writ of certiorari, that they were denied due process. Pet. 31-37. That argument was not presented to either the district court or the court of appeals. It is well-settled that this Court rarely reviews matters that were not raised below or passed upon by

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[2] Petitioners are likewise wrong in arguing (Pet. 20-21) that the decision below conflicts with the Second Circuit's ruling in *CFTC* v. *British American Commodity Options Corp.*, 560 F.2d 135, 138 (1977). Petitioners base their claim of a conflict exclusively on the Second Circuit's statement that, under the CEA, "persons *actively involved in commodities trading* shall be registered with the Commission." Pet. 21 (quoting *British American Options Corp.*, 560 F.2d at 138). Even read in isolation, that statement is not inconsistent with the understanding that the Act's registration requirements also extend to some persons who do not actively trade in commodities futures but who solicit funds for use in such trading. In any event, the Second Circuit had no occasion in that case to construe the statutory definition of "commodity pool operator."

the court of appeals. See, *e.g.*, *Bivens* v. *Six Unknown Named Agents of Fed. Bureau of Narcotics*, 403 U.S. 388, 398-399 (1971); *Adickes* v. *S.H. Kress & Co.*, 398 U.S. 144, 147 n.2 (1970); *Taylor* v. *Freeland & Kronz*, 503 U.S. 638, 645-646 (1992). This is especially true here, as petitioners' due process claim relates solely to the district court's handling of this particular case and raises no legal issues of general significance.

In any event, petitioners' due process argument lacks merit. Petitioners contend (Pet. 32-34) that they were deprived of their "right to be heard" because the district court did not address in sufficient detail the arguments they made in their respective motions for summary judgment. Petitioners had ample opportunity to be heard on the commodity pool issue; indeed, they briefed and argued that issue at least three times before the district court, and again before the court of appeals. Petitioners cite no authority for the proposition that the Due Process Clause required the district court or the court of appeals to address their arguments at any particular level of detail. In any event, the record reflects careful analysis of the disputed statutory question by both of the courts below. See Pet. App. 12a-25a, 37a-41a, 48a-52a.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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